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C O N F I D E N T I A L SECTION 01 OF 02 MANAMA 001570

SIPDIS

NEA/ARPI, EB/TRA

E.O. 12958: DECL: 10/23/2015
TAGS: EAIR ETRD ECON BEXP BA
SUBJECT: GULF AIR'S FUTURE IN WAKE OF UAE PULLOUT

Classified By: Ambassador William T. Monroe, reasons 1.4 (b) and (d)

Summary

¶1. (C) Minister of Transportation Shaikh Ali bin Khalifa Al Khalifa discussed with the Ambassador Gulf Air's future in the wake of the UAE's withdrawal from ownership of the airline. Shaikh Ali said the GOB would expect the UAE to honor its existing financial commitment to the carrier. He fears that Oman may withdraw from the carrier too but pledges that Gulf Air will receive Bahrain's continuing support. He supports Boeing over Airbus to replace the aircraft in Gulf Air's fleet, as does Gulf Air President and CEO James Hogan, although Hogan acknowledged that, given Gulf Air's current fleet composition, Boeing's bid would have to be more aggressive than Airbus' to win the deal. He said that Gulf Air is facing a "moment of truth" as it deals with its latest restructuring and purchase of new aircraft. Hogan is interested in offering service to Iraq and Afghanistan. Despite rising fuel prices, Gulf Air ended 2004 with its strongest year since 1997. End Summary.

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Transportation Minister Discusses Gulf Air's Future
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¶2. (U) Deputy Prime Minister and Minister of Transportation Shaikh Ali bin Khalifa Al Khalifa October 12 discussed the future of national flag carrier Gulf Air with the Ambassador. The meeting followed the September 13 UAE announcement that Abu Dhabi would pull out of Gulf Air in six month's time. The UAE's withdrawal leaves the carrier's ownership in the hands of the Bahraini and Omani governments.

¶3. (C) Shaikh Ali said the Crown Prince had met with the Abu Dhabi leadership in the summer of 2004 and was assured that Abu Dhabi remained committed to Gulf Air. The decision to drop out now caught the GOB by surprise, though he noted that with the UAE launch of Etihad Airlines, Bahraini officials had worried that this would happen.

¶4. (C) He said that several months ago, the Gulf Air board, which consisted of members from all three country members, approved a cash infusion of BD 90 million ($235 million) for Gulf Air, with each country paying BD 30 million. Bahrain paid up immediately. Oman paid up just the day before (October 11). He said Abu Dhabi has not paid its agreed share and asserted that Bahrain will insist that Abu Dhabi fulfill its commitment.

¶5. (C) Shaikh Ali said the three countries have six months to work out the disassociation of Abu Dhabi from the airline, including division of routes and decisions on planes. He said that Bahrain does not favor making Oman a co-hub. The traffic has just not been high enough out of Oman. He cited as an example that Oman has insisted that Gulf Air fly daily from Muscat to London, as it does from Abu Dhabi and Bahrain. However, the Muscat flight is routinely undersold compared to the Bahrain and Abu Dhabi flights. Also, despite assurances from the Government of Oman that it is committed to remain a part of Gulf Air, he confided that Bahrain is wary that sooner or later Oman will drop out, just as Doha did in May 2002 and Abu Dhabi has done now (despite regular prior assurances that they would remain as partners).

¶6. (C) Shaikh Ali said Gulf Air is critical to the economy of Bahrain as a major employer and that Bahrain will not let Gulf Air fail. It is considering privatization as an option -- getting the government out of the operation of Gulf Air.

Boeing Favored

¶7. (C) Regarding Gulf Air's planned purchase to update its fleet, Shaikh Ali expressed his strong support for Boeing over Airbus, but said Boeing still must bid aggressively in order to secure the deal.

¶8. (C) Gulf Air President and CEO James Hogan told the Ambassador October 18 that the airline's engineering department also favored Boeing over Airbus. He said funds

had already been allocated and the carrier would need to place an order by year end to replace its entire 34-aircraft fleet, noting that current manufacturing backlogs meant the ordered planes would not go into production until 2010. Hogan said his current fleet consists of a 70/30 mix of Airbus and Boeing aircraft. He said that Boeing had an excellent opportunity to become the dominant carrier at Gulf Air, but acknowledged that Boeing would have to be more aggressive than Airbus in its bid to win the contract because of the need to dispose of more Airbus aircraft if Boeing gets the deal.

Impact of UAE Withdrawal

¶9. (U) Hogan expressed optimism on Gulf Air's future in the wake of the UAE's departure. In contrast to Shaikh Ali, Hogan was more optimistic about the possibility of keeping Oman as a second hub. "Two hubs are easier than three," he said. He noted that some bilateral aviation agreements would need to be updated, but said that Gulf Air would keep its current routes and airport slots.

¶10. (SBU) He added that the Bahrain hub demonstrated greater strength in serving the Southeast Asian market, while Oman did comparatively better in the European market, despite Bahrain's better performance on the London route. (Note: Gulf Air recently signed a frequent flyer agreement with India's Jet Airways and announced October 24 that it seeks to triple its flights to Manila. End Note.)

Iraq/Afghanistan Gateways Eyed

¶11. (SBU) Hogan expressed interest in opening a gateway in Kabul if conditions were conducive and the Afghan Civil Aviation Authority (CAA) was supportive. (Note: Following contact with Embassy Kabul, the Ambassador October 23 advised Hogan that, subject to the existence of a bilateral aviation agreement, the Afghan Ministry of Transport would likely view Gulf Air overtures favorably. End Note.)

¶12. (C) Hogan also inquired as to whether conditions in Basra, Baghdad and Kurdistan would presently support Gulf Air flights. He said that Gulf Air has on the table a proposal to fly a Manama-Baghdad-New York route once conditions warrant it. Following contact with Embassy Baghdad, Ambassador provided Hogan with contact information for the Iraqi CAA.

Performance

¶13. (SBU) Hogan said high oil prices would limit Gulf Air's ability to expand and noted that as early as 2002, he had recommended to the board of directors that Gulf Air purchase fuel oil hedge contracts. To his chagrin, the board declined to implement his recommendation. Gulf Air paid BD 30 million (approximately $80 million) in fuel costs in 2004.

¶14. (U) Nevertheless, on October 23, the carrier announced a 2004 net profit of BD 1.5 million ($4 million). This marked the airline's strongest financial performance since 1997. Gulf Air's overall load factor for 2004 was 71.4 percent, an increase of 4.8 percent over the previous year. Gulf Air's all-economy subsidiary, Gulf Traveler, logged an average load factor of 75.8 percent across its 17-gateway network last year.

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